MINUTES
of the
FIRST MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

June 6, 2014
Room 307, State Capitol
Santa Fe

The first meeting in 2014 of the Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Representative Edward C. Sandoval, chair, on Friday, June 6, 2014, at 10:01 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Rep. Edward C. Sandoval, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Sue Wilson Beffort
Rep. Anna M. Crook
Rep. Rodolpho "Rudy" S. Martinez
Rep. Henry Kiki Saavedra
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Sen. Peter Wirth

Absent
Rep. Brian F. Egolf, Jr.
Sen. Timothy M. Keller
Sen. Mark Moores
Sen. Lisa A. Torraco
Rep. Bob Wooley

Designees
Rep. Jason C. Harper
Rep. Luciano "Lucky" Varela

Rep. Donald E. Bratton
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Ernest H. Chavez
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Rep. Bill McCamley
Sen. George K. Munoz
Rep. Paul A. Pacheco
Rep. Dennis J. Roch
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez

Sen. John M. Sapien
Rep. Carl Trujillo
Sen. Pat Woods

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Caela Baker, Staff Attorney, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Michelle Jaschke, Researcher, LCS
Tessa Ryan, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Friday, June 6</u>

Post-Session Fiscal Report

David Abbey, director, Legislative Finance Committee (LFC), and Peter van Moorsel, chief economist, LFC, updated the committee on the state's fiscal status. They turned the committee's attention to the state's most recent appropriations and to revenue trends and projections.

Mr. Abbey said that fiscal year (FY) 2015 general fund spending, as authorized by the General Appropriation Act of 2014, will reach the highest level in the state's history: $6.16 billion, an increase of 4.6% from the previous fiscal year. The year's capital outlay appropriations, for which the challenge persists of getting projects to shovel-ready status so that money may be spent, total $630.4 million. He discussed general fund recurring appropriations from FY 1989 through FY 2015, commenting that the growth rate in spending in the 20 years before FY 2009, 6.75%, was less sustainable than the current rate of 5.3%.

Mr. Abbey provided a snapshot of the state's spending since FY 2007. Following a recession-caused dip in revenues, the state had begun and continues to restore its programs. This year, much of the newly available revenue will be dedicated to strengthening state initiatives in areas such as early childhood development, education and health care. Most of the increase in FY 2015 general fund spending falls in the categories of public schools and higher education. Meanwhile, some FY 2015 spending will support across-the-board and targeted salary increases.

Mr. Abbey delineated the planned uses of some spending increases, namely, $26 million for early childhood education, $147.7 million for public schools and $42.5 million for higher education. He noted that limitations in related infrastructure prevent rapid growth in the area of child care assistance and that there is a push to increase the rates of payment for child care services.

Remarking on the relationship of Medicaid to the state budget, Mr. Abbey highlighted some relevant state statistics and presented a graph showing the revenue sources and amounts associated with Medicaid spending in fiscal years 2009 through 2020. The state's general fund contributions to the program will gradually increase beginning in FY 2016.

Mr. Abbey reported on revenues in general and on the amount of state money held, and projected to be held, in reserve. To date, revenues, much of which are recurring, are higher than forecasted. This is in part because oil and gas production has increased. It is anticipated that the state's reserves will be 9.2% at the end of FY 2014 and 9% at the end of FY 2015. Mr. Abbey rebutted the opinion of some that 9% is too high by arguing that the somewhat-likely deficiency of approximately $65 million for the Human Services Department (HSD) and a $30 million special education maintenance-of-effort contingency justify setting the reserves at that level. He also noted the risks posed by recent cash reconciliation/accounting issues, low reliability of employment data, lottery scholarship program obligations and uncertainty in federal spending.

On questioning, Mr. Abbey, Mr. van Moorsel and committee members addressed the following topics.

Highway maintenance and repair. A committee member remarked on the need for improvements in transportation infrastructure funding. Another committee member requested that, at the planned joint meeting of the RSTP and the Transportation Infrastructure Revenue Subcommittee, the LFC present options for overcoming challenges in transportation infrastructure funding. Options should include adjusting the percentage of severance tax revenue dedicated for other purposes and directing some of that revenue to transportation infrastructure development. A third committee member stressed the need for a long-term solution to the transportation-revenue problem and proposed that an increase in the fuel tax rate be part of it.

Oil and gas industry-driven revenues. A committee member cautioned against forecasting revenue from the oil and gas industry at high levels because of factors — such as the federal control over certain oil- and gas-rich lands and delays caused by the federal permitting process — that prevent revenues from reaching their full potential. Mr. Abbey responded that those forecasts were made conservatively.

Eligibility for subsidized child care. The Children, Youth and Families Department may adjust the poverty-based eligibility requirements for receiving child care, but the legislature has ultimate control over funding levels.

Jobs. A committee member expressed interest in hearing a report by the Workforce Solutions Department on the effects, both here and in other states, of cuts in funding for federal laboratories on private-contractor enterprise. Other committee members echoed the concern about job losses, particularly in the mining, oil and gas industries. One member added that there appears to be a disconnect between the jobs of the world-oriented future marketplace and the skills that people are being trained for today.

2014 Legislative Session: Budget and Tax Policy Update

Tom Clifford, secretary, Department of Finance and Administration (DFA), offered the committee information on current and projected revenues, on FY 2015 appropriations, on the targets of some new spending and on tax policies. Ryan Gleason, tax policy and research director, Taxation and Revenue Department (TRD), elaborated on Secretary Clifford's presentation by reviewing tax-related legislation passed in the 2014 regular session.

Secretary Clifford compared several revenue sources' original and revised forecasted growth levels, noting that the greatest discrepancy is in the category of oil and gas production. Like Mr. Abbey, he acknowledged the recent strength, but also the fickleness, of revenue generation from that industry. Secretary Clifford identified many of the risks affecting revenue projections that Mr. Abbey noted, including the HSD deficiency, the public employees' union lawsuit (for which, Secretary Clifford said, it appears that about two or three agencies will face a deficiency), cash reconciliation/accounting issues, future increases in state spending for Medicaid, the lottery scholarship program and federal spending cuts. He further pointed out that circumstances related to the tobacco settlement, uncertainty in tax liability (e.g., uncertainty caused by a lawsuit initiated by the City of Eunice) and the higher education funding formula threaten to alter revenue and spending projections.

Secretary Clifford commented on certain FY 2015 appropriations. In the area of economic development, money to continue implementation of the Local Economic Development Act increased significantly, which, according to Secretary Clifford, was an influential factor in Tesla's ongoing consideration of New Mexico as a state in which to build its planned factory. Moreover, funding to implement the Job Training Incentive Program has been established as recurring, and the budget for tourism advertising has increased. In the area of capital outlay, Secretary Clifford provided an overview of funding by project type and highlighted certain capital outlay-related developments, including some related to Executive Order 2013-006 (which pertained to audit and budget compliance).

Secretary Clifford noted several state initiatives effected in part by targeted spending, including public education reforms and improvements in the health care work force. He described legislative measures to improve the solvency of the lottery scholarship program, saying that more changes will be needed to prevent future shortfalls. He called the committee's attention to issues associated with safety net hospital funding and judicial pension solvency.

On the topic of tax policy, Secretary Clifford mentioned certain changes to law made in the most recent session: an extension to the net operating loss carry forward provision; an expansion of the aircraft parts and services deduction; and the creation of an aircraft sales deduction. He remarked on some topics that he said represent challenges in tax policy, including the burden imposed on small businesses, tax pyramiding, tax on remote sales, local gross receipts taxing options and the independence of hearing officers.

Mr. Gleason characterized the two aircraft-related provisions as narrowly targeted and added that the net operating loss measure will not have a fiscal impact for the first four years of its effectiveness. He remarked on two other tax-related pieces of legislation, the dialysis facility services and the durable medical equipment deductions, and he elaborated on the Eunice lawsuit.

The case called into question whether the City of Eunice should be held harmless for a taxpayer's errors that resulted in what were later discovered to be erroneous distributions by the TRD to the city. The New Mexico Court of Appeals ruled that a one-year statute of limitations applied, and so the TRD could withhold from its future distributions to the city only the amount erroneously distributed in that period. Mr. Gleason reported that the TRD is deciding how to proceed and whether to propose legislation that would prevent a recurrence of similar situations.

On questioning, Secretary Clifford, Mr. Gleason and committee members addressed the following topics.

Tax reform. Secretary Clifford said that there have not been active discussions within the executive branch about tax reform. He added that the governor would most likely support a broadening of the tax base only if the corresponding rate decreased. A committee member stressed the importance of cooperation by executive branch agencies in providing information for the committee's planned comprehensive review of the gross receipts tax.

Reserves. The discrepancy between the LFC's and the DFA's reported reserve levels stems in large part from the differences in approach to handling the payments required by the public employees' union lawsuit court order.

High-wage jobs tax credit. Issues related to claims are being addressed by the TRD in its consultation with the Economic Development Department.

Eunice lawsuit. A committee member commented that rural communities like Eunice have a harder time maintaining stable revenue levels than larger ones do. The member requested information on the amounts of hold harmless payments to local governments.

Accuracy of predicting effect of tax proposals. A committee member pointed out that the TRD lacks the tools necessary for accurately predicting the revenue changes that proposed tax legislation would cause if implemented.

Higher education funding. A committee member commented that there appears to be wasteful spending in higher education and asked that the issue of that inefficiency be addressed.

Updated Tax Deviation Report; Discussion of Work Plan and Meeting Schedule

Ms. Stokes commented on a report, which was distributed to committee members, in which information about the state's tax credits, tax deductions, tax exemptions and other deviations from the tax structure is compiled. She said that the revised report is easier to read and better organized than the version from last year.

Ms. Stokes presented the committee's proposed work plan and meeting schedule for the 2014 interim. Members recommended the addition of some items and then adopted the plan.

Proposal for a Comprehensive Review of the Gross Receipts Tax

Richard Anklam, president and executive director, New Mexico Tax Research Institute, and Jim O'Neill, consultant, O'Neill Consulting LLC, elaborated on their proposal for work intended to identify ways to reform the general excise tax, commonly referred to as the gross receipts tax. They outlined the perceived problem and some possible solutions to it.

In sum, Mr. Anklam and Mr. O'Neill pointed out that the tax is incompatible with the modern economy. The tax was created in the 1960s as a broad-based tax on business receipts. But the state and world have changed since then; New Mexico sellers now face more competition. Lawmakers' general response to the new climate has been to relieve taxpayers on a piecemeal basis. That response has shrunken the tax base and increased the rate.

Mr. Anklam and Mr. O'Neill articulated two possible solutions, both of which would do away with the gross receipts tax. A turnover tax or a consumption tax could be implemented in its place.

The presenters proposed a two-step process that would span two interims. In the first stage, information would be collected and assembled in a useful form. In the second stage, policy and design questions would be addressed.

On questioning, Mr. Anklam, Mr. O'Neill and committee members addressed the following topics.

Costs of and expert involvement in the work. The costs of the work are not certain. More research involving the TRD would need to be conducted before developing a firm total. Experts would be used to validate findings and provide estimates on data that the TRD cannot provide. A committee member stressed that, because accuracy is essential, the project should include experts. Another stated the importance of legislators understanding how their policy choices will affect revenues. Upon a motion made and seconded, the committee authorized the chair and vice chair to speak for the committee in asking the New Mexico Legislative Council for money to pay for the project.

The broken tax system. A committee member remarked that, over time, special interests have lobbied for carve-outs from the original system, rendering it fractured. The state needs a system. Another committee member characterized the current system as regressive and urged that more progressivity become a feature. Further, in order to keep total revenue at a stable level, the entire tax code might need to be reformed. Other committee members recommended reevaluating the property tax along with other changes. Mr. Anklam responded that other taxes might also have to be considered for reform, but understanding more fully the gross receipts tax is an appropriate first step. Lastly, a committee member commented that protecting the state's permanent funds would reduce the amount in tax that people would be required to pay and would stabilize the fluctuation in revenues from the oil and gas industries.

There being no further business, the committee adjourned at 1:27 p.m.